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REVIEW OF THE YEAR 1921

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FOR the United States the year 1921 naturally divides into two periods, which were, respectively, of five and seven months duration. From January to May the forces making for general liquidation had the upper hand, and commodity prices and business activity steadily declined. Improvement was indeed taking place in industries which had been the earliest to liquidate; but the general trend was downward, although at a perceptibly diminishing rate. This period marked the end of the wave of general liquidation which broke in the spring of 1920, and constituted the last phase of the business cycle which began early in 1919. In June the second period opened with an upward turn of commodity prices and business activity, which by August had brought substantial recovery from the trough of the depression. The fall months saw further improvement, although somewhat less than the seasonal amount; and then, with the approach of winter, came a normal slackening of trade and industry. This second period undoubtedly marked the beginning, or first phase, of a new business cycle; and conditions at the end of the year, while still unsatisfactory, showed such substantial improvement over those prevailing in May as to make it clear that recovery had definitely set in and that better things were in prospect for 1922.

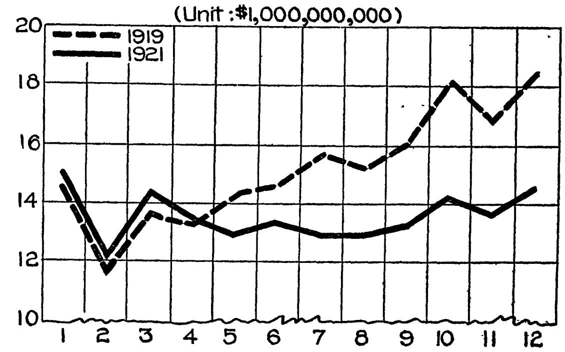
The REVIEW OF ECONOMIC STATISTICS has recorded from month to month the important developments of the year, and this article will attempt nothing more than an appraisal of their significance. The outstanding fact is that, in spite of the havoc wrought by a world-wide upheaval of unprecedented magnitude and severity, the general movement of business in the United States proceeded about as was to be expected during the concluding phase of one business cycle and the opening phase of another. This has been hard for many business men and economists to appreciate. In the grip of the world-wide convulsion and apparently at the mercy of blind forces that operated in defiance of economic law, it seemed not unreasonable to suppose that the old landmarks had been swept away and that past experience or precedent must be of slight value. For those closest to the critical developments that must somehow be met from day to day, a philosophical view of the appalling situation was almost impossible; while for those suffering the heaviest losses there was no comfort in any philosophy. The scientific observer had difficulty enough in keeping his bearings, and it was not without some surprise that the editors of the REVIEW observed and recorded developments which, upon the whole, turned out to be what previous experience would lead one to expect. The terrific recession of business activity which was in full swing at the end of 1920 came to an end within one month of the expected time; and the process of recovery has been marked by the usual developments, namely, easier money, recovery of security and commodity markets, and a gradual increase of business activity. The present year may run counter to all precedent and disappoint reasonable expectations premised upon the developments of 1921, but there is less reason for expecting such an outcome than there was twelve months ago for believing that judgments based upon past experience would prove worthless under the extraordinary conditions resulting from the world war.

In our opinion the most substantial and important achievements of the past year in the United States have been the return of easy money, the stabilization of wholesale prices, and the recovery of security markets. These things were bound to occur if the old landmarks of business had not been obliterated, and they have come to pass in about the normal time and sequence. Such developments are important in themselves, and are even more important because they could not have occurred unless a much larger number of other fundamental factors were operating in the direction of business revival. The process has been slow at times, and has been and still is hindered by unfavorable conditions in Europe; but it is going on nevertheless. That the United States should have turned the corner earlier than the other chief belligerent countries is not surprising in view of the facts: that we are not obliged to depart from a specie basis, that we suffered less from the ravages of war, and that political and international complications have not so greatly obstructed our return to a normal status.

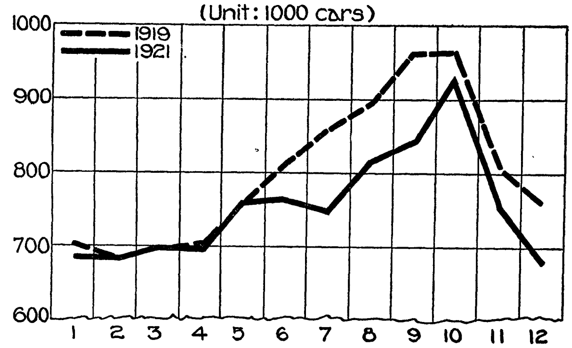
The general course of business in 1921 and the interpretation which should be placed upon it can be made somewhat clearer by a comparison with the year 1919. Both years opened with a low level of business activity due, in the one case, to the temporary depression that followed the armistice and, in the other, to the severe liquidation which began in the spring of 1920. In both cases a turning point was presently reached, in April of the earlier year and in June of the later. Then followed a revival of business constituting the first phase of a new business cycle; but in 1919 this revival was rapid and presently developed into a tremendous boom, while in 1921 it was slow and halting on account of the magnitude and the severity of the readjustments which were necessary. We should expect, therefore, considerable similarity in the movement of business during the earlier part of the year, and in the latter part should expect to find that 1921 lagged behind 1919 although it recorded a movement that was generally upward. The best data for such a comparison are afforded by statistics showing bank clearings outside of New York and freight car loadings,[1] since these give the best available record of the volume of business activity. Wholesale commodity prices and production statistics might also be used; but the evidence these series afford would be merely cumulative, and the data are therefore not reproduced. For outside clearings and freight car loadings the movements were as follows:

[1] The figures for car loadings are monthly averages of the weekly loadings.

BANK CLEARINGS OUTSIDE NEW YORK CITY
(Unit: $1,000,000,000)



FREIGHT CAR LOADINGS
(Unit: 1000 cars)



These charts invite comparison at numerous points, but the principal conclusions to be drawn from them are that both 1919 and 1921 were years in which an initial period of depression was followed by a recovery which was rapid and very marked in the former year and slow and very moderate in the latter. It is to be observed further that the difference between the movements recorded in the last half of each year was greater in the case of bank clearings than of freight car loadings because of the inflated price level reached in 1919. Upon the whole, these statistics confirm our conclusion that the last half of 1921 saw a gradual recovery of business, which, although proceeding slowly and at times very haltingly, has steadily progressed even under the difficult conditions prevailing throughout the world. They certainly afford no justification for the belief somewhat widely entertained that we are living in such abnormal times that no theories based upon pre-war experience can have any value for the student of business conditions.

The decline of money rates was very gradual during the early months of the year at the season when such rates normally fall somewhat sharply. It was not until May that the first reductions of rediscount rates were made by the federal reserve banks, and during the winter and early spring sharp difference of opinion existed concerning the advisability of such reductions. In the East it was generally believed that liquidation had proceeded far enough to justify lower rates of rediscount; but in the West and South liquidation was not so far advanced, and it is probable that earlier reductions would have retarded the process very materially. After May, however, rediscount and other rates underwent a steady downward revision, and by August it was clear that the period of easy money was at hand. From a rate of 7 per cent on loans not secured by Liberty Bonds or Victory Notes, the rediscount rate of the New York Federal Reserve Bank had declined to 4½ per cent by the end of the year, and the prospect is that a rate of 4 per cent lies not very far ahead. Commercial and other interest rates have naturally shown a similar downward trend.

Banking statistics reflect the conditions which have made easy money possible. Bills discounted by the federal reserve banks have declined from $2,608,000,000 on January 7, 1921 to $987,000,000 on January 11, 1922; and cash reserves have increased from $2,277,000,000 to $3,041,000,000 during the same period, while federal reserve notes in actual circulation have declined from $3,270,000,000 to $2,294,000,000. Reporting member banks show a similar trend, though, naturally enough, in a much less degree. From $15,291,000,000 on January 7, 1921, their loans and investments, including bills rediscounted but excluding United States securities, decreased to $13,302,000,000 on January 4, 1922, while their aggregate deposits declined from $13,966,000,000 on the former date to $12,996,000,000 on August 24, since which time they have increased to $13,685,000,000. Meanwhile bills rediscounted and bills payable with the federal reserve banks have declined from a total of $2,050,000,000 to $647,000,000.

All this has spelled deflation of a very drastic character, but it has been accomplished without disaster. Almost inevitably it has led to loud complaints, especially from the agricultural districts which are inclined to look upon the federal reserve system as the cause of the reaction which has affected them so severely. It has also caused the enactment by Congress of measures like the revival of the War Finance Corporation and the added facilities granted the farm loan banks, which are designed to help the agricultural situation and may perhaps accomplish something in that direction.

Something of this sort was practically certain to follow the first attempt of the federal reserve authorities to impose salutary restraints upon a movement which, if continued, would have brought overwhelming disaster. An elastic banking system, such as we have at last attained, does not imply extension of credit until the breaking point is reached; but on the contrary requires that expansion shall be checked before we come to the breaking point. The federal reserve authorities are fairly open to the criticism that in 1919 they permitted expansion to go too far; but for this the financial requirements of the government were responsible, and the Reserve Board adopted the necessary cautionary measures as soon as the heavy hand of the government relaxed its control. For the unwise expansion of that year responsibility lies with the unfortunate determination of the Treasury to float government loans at less than the market rate, and the troubles that befell in 1920 were due to the fact that credit had been too liberally extended more than to any other single cause. After the debauch of cheap money and easy credit the patient usually objects when an additional supply of stimulant is refused. This has always been true in the past, and it is the principal explanation of what is happening today. When the federal reserve system was established, it was clear that, by centralizing bank reserves, it created a new reservoir of credit, which was likely, sooner or or later, to lead to inflation. But it was probably not so clear to the average man that, unless the system was going to lead to disaster, the flow of credit from the reservoir must be kept under control, as it has been since the requirements of the Treasury were satisfied in 1919. This has meant disillusionment to all who see in "easy money" a certain recipe for prosperity, and it is not strange that the Federal Reserve Board has been under constant attack. One lesson of the past year is that much educational work remains to be done before the real nature and necessary limitations of an elastic banking system are fully understood by the people of the United States.

Security markets during 1921 moved in a perplexing manner, but since last July the general trend has been upward. Our methods of measuring speculative activity at the present time are less satisfactory than they were before the war because it has been impossible to use statistics relating to bond yields and the prices of railroad stocks. The result has been that, in our speculative curve, security values are now represented only by industrial stocks upon which selling pressure has been especially concentrated since November 1919. In time, as the bond market returns to the post-war normal and railroad stocks recover their former investment status, we can begin to use these series again and shall have a better measure of speculative activity than we now possess. According to our present record, speculative activity reached a low point last July whereas business activity turned upward in June, with the result that on this movement the turn of business appears to have come before the turn of speculation. It is possible, however, and even probable, that, if we could have used statistics for bond yields and prices of railroad stocks, it would have appeared that speculation really turned upward sometime before curve A actually moved upward on our chart. At all events, the improvement in investment markets during the last half of the year followed the usual pre-war rule. The coming of cheap money was reflected first in the prices of bonds and then, after an interval, in those of the best preferred stocks. Not until November did industrial stocks begin to move definitely upward, with the result that our speculative curve, at the end of the year, appeared definitely to forecast a revival of business activity during the spring of 1922. There can be no mistake about the character and significance of the movement of the bond market in the last half of 1921, and it is probable that the recovery of stock prices during the last two or three months means, in conjunction with the downward trend of money, a definite and substantial improvement of business conditions in 1922.

We are aware that some intelligent observers believe that the present movement of stock prices is temporary and is based upon nothing more substantial than cheap money and the mistaken notion that business has "turned the corner." Both of these influences have doubtless played their part; but cheap money is one of the substantial forces that always make for recovery after a period of liquidation, and the belief that business in 1921 did "turn the corner" is substantiated by evidence that is not vague and is very definite. Undoubtedly the outlook is still clouded, especially upon the European horizon. Undoubtedly, too, security prices cannot continue to advance much longer without further stimulus than is afforded by optimism and cheap money. But if the turn in business activity actually came last summer, as the evidence indicates, increased earnings will presently materialize; and it is reasonable to believe that the market is now discounting the return of greater prosperity next spring. Since this article is a review rather than a forecast it cannot give further consideration to the business outlook for 1922.[1] But in order to avoid misconstruction it will be well to add that we see no reason to expect anything more than a return of a fair degree of prosperity this year. It is to be borne in mind, furthermore, that when one thinks of prosperity he should not think of such profits as were realized — *on paper* — between 1915 and 1919. The return to normal means, among other things, normal rates of profit which, although of modest proportions, will prove more substantial than those of the period of inflation which came to an end in 1920.

The abrupt decline of commodity prices was arrested by the middle of the year, and since that time there has been a moderate upward movement in the United States. Bradstreet's index stood at $11.31 in December as compared with $10.62 in June. In Europe there were evidences of price stabilization during the summer; but in the fall further declines ensued, which, in some cases, appear to be about proportional to the improvement that has occurred in rates of exchange. Further evidence and much more careful analysis would be needed to determine whether world prices have reached a level which will be comparatively stable during 1922; but except in nations where the printing presses continue their deadly work, there is reason for believing that such is the case. In the United States, at any rate, it is probable that the year 1921 saw the end of the decline that began in the spring of 1920; and that, during the first half of

[1] This subject has been treated by Professor Persons in our *Weekly Letter* of January 21, 1922.

the business cycle which began early last summer, wholesale commodity prices are likely to show at least a moderate increase. This does not mean that liquidation is over in every industry or that retail prices and the cost of living may not undergo further declines, but it does mean that we have reached a point at which business may with considerable confidence make its plans for the next twelve or eighteen months.

This country's foreign trade has undergone the readjustments that were inevitable in a period of world-wide liquidation. Values have declined more rapidly than the physical volume of exports or imports, but the decrease in both has been noteworthy and the excess of exports has shown a substantial decline. All these facts are recorded elsewhere in our publications and it is necessary in this article merely to appraise their significance. The first thing to be observed is that 1921 has disappointed the extravagant expectations which were entertained so widely a few years ago. We have not become, at a single bound, a nation of foreign traders; and it is clear that hard work and intelligent planning will be necessary to maintain the position we ought to hold in this field. We have lost the unusual opportunities enjoyed while our principal rivals were devoting their energies to the prosecution of the Great War, and must build up again along the lines we were pursuing prior to 1914, while endeavoring to utilize the experience acquired and to retain what we can of the gains made since that year. As was pointed out in our *Letter* of December 12, it is not yet clear "that we have yet 'turned the corner' in foreign trade." Between the spring and fall months exports seem to have become stabilized, but their failure to expand as they normally do in September and October leaves the future in some doubt. In imports there is as yet no evidence that either in respect of their value or their quantity the low point has been reached. Gold has continued to move to the United States throughout the year, the net imports during the twelve months amounting to $668,000,000, which constitutes a new high record. In 1915 and 1916, when war business was bringing us a flood of gold, the excess of imports amounted to only $420,000,000 and $530,000,000 respectively.

The immediate future of our foreign trade is, of course, intimately connected with conditions prevailing in Europe, and these are difficult to appraise. During the past year it seems clear that Great Britain, France, and Italy have managed to bring currency expansion to an end, and in various directions, though not in equal degree, have improved their economic condition. Trade depression is not over, many things remain to be adjusted, but upon the whole the year has closed in a manner that affords reason for encouragement. Apart from the Russian situation, which remains as difficult and enigmatical as ever, the principal problem confronting Europe is that of German reparations. The terms proposed last spring, to which Germany acceded, involved a substantial reduction in the claims of the Allied powers; but it is now evident that they call for more than Germany can be expected to pay. The question is not, and never has been, one that could be determined with sole or principal reference to the equities of the case. It is one that should be settled with reference to economic possibilities, and it has been complicated by political considerations and by the natural and proper desire of France for security. Probably it is one of those things which have to grow worse before they can get better, since in the existing state of public feeling it is hard for the nations which were the chief sufferers by the war to face the hard economic facts. These are, as we see them, that reparation payments can be made only by the export of German commodities and by utilizing German labor in the reconstruction of the devastated regions. The latter resource can be employed only to a limited extent, and the bulk of payments must be financed by the export of commodities which other countries do not want to receive. Even if Germany had not lost both territory and trade as the result of the war, a study of export and import statistics would prove that the present demands exceed the range of commercial possibilities and must be materially reduced. More than this, the terms of the settlement must enable the Germans to see a chance of completing the payments within a definite time of not unreasonable length. Otherwise, the outlook will become hopeless and there will be little inducement to put forth the country's best efforts to make repayment. The same economic motives control in Germany as elsewhere, and no solution can be reached until the amount and terms of the reparation demands are adjusted to the present possibilities of the case. The conference at Cannes seemed to promise hope of material progress in the right direction, but this has been disappointed by recent developments in France so that the question remains about where it rested a year ago except for the fact that it is now more generally realized that excessive demands must defeat their own end. A prolonged trade depression was necessary to bring the people of England to an appreciation of the realities about reparations, and it may be hoped that the logic of events will bring similar disillusionment in France.

In the United States the last year has brought us somewhat nearer a true appraisal of our international position and responsibilities. In farming communities there is better appreciation of the stake we have in the reconstruction of Europe, and in manufacturing districts there is growing recognition of the fact that we can receive interest on our foreign debts only by taking payment in imports. The Washington Conference seems likely to yield important results, and may produce a better feeling throughout the world, which will make it easier for us to coöperate in the rehabilitation of Europe. We have suffered from overzealous advocates of international policies which could be of little avail until Europe is ready to face the facts about reparations payments, and from a disposition of other extremists to wash our hands of European affairs. The last year has not brought us to a point where we can agree upon an intelligent and farsighted policy; but we have made progress in that direction, and 1922 will probably record a further advance. Meanwhile we shall find that our return to prosperity will be retarded by the disturbed condition of Europe, and we cannot expect that foreign demands for our products will help to lift us out of business depression as it has often done before in similar situations.

Under these circumstances we should be careful neither to exaggerate nor underestimate the relative importance of our foreign trade. Prior to the war the value of exports seems to have been approximately 8 per cent of the total value of commodities produced in the United States. The war increased this percentage until it stood at something over 13 per cent in 1919.[1] We have clearly lost the stimulus which our trade experienced during the war, and in this respect, as in others, must return to more normal conditions. Most of the shock of this process was probably absorbed in 1921, so that there is reason for feeling hopeful about the present year. If our foreign trade has not yet turned the corner, we may expect that it will do so before long; and, while waiting for this adjustment to be completed, we may reasonably count upon an improvement of domestic trade sufficient to continue the upward trend of business activity which began six or eight months ago.

[1] See Review of Economic Statistics, 1921, page 4.